

Clients & Friends Memo

2016 PROXY SEASON – QUICK REFERENCE GUIDE

December 17, 2015

The year is coming to an end and the 2016 proxy season is on the horizon. This quick reference guide identifies considerations based on themes from 2015, offers recommendations and resources for the upcoming season, and discusses expected future changes in disclosure rules that public companies will want to keep on their radar as proxy preparations begin.

TIPS FROM THE 2015 PROXY SEASON

- Does your company have a **board evaluation process**? Consider disclosing the evaluation process to show how the board identifies and addresses gaps in skills and viewpoints, as well as how the board approaches issues around **tenure**, **diversity** and **succession**. Investors also want to know how the specific experience and expertise of directors helps them oversee corporate risks and provide meaningful insight and guidance to management.
- Keep in mind that there is an increasing likelihood that investors and the SEC will be looking for information concerning boards' oversight of **cyber risks**. You can review SEC guidance on cybersecurity disclosure [here](#).
- Prepare for and consider how to respond to shareholder proposals, including **proxy access proposals**. In October, the SEC Staff issued a [legal bulletin](#) clarifying when a company may **exclude a shareholder proposal** on the basis that the proposal "directly conflicts" with a management proposal along with commentary on the ordinary business exclusion. The Staff will not conclude that a shareholder proposal directly conflicts with a management proposal if a reasonable shareholder could logically vote for both proposals. As a result, it will be difficult to successfully exclude a shareholder proxy access proposal by offering alternative proxy access parameters. Exclusions based on the substantially implemented basis might become the next battleground.
- Start **shareholder engagement early**. Make public how shareholders can communicate and engage with your company and/or board. Consider the guidelines provided in the [SDX Protocol](#) to establish a framework for shareholder-director engagements. Be proactive about identifying your company's vulnerabilities to prepare for investor discussions.

RECOMMENDATIONS AND RESOURCES FOR 2016

- [ISS](#) and [Glass Lewis](#) have issued their annual policy guidelines for 2016. ISS also released a summary of its [2015-2016 ISS Global Policy Survey](#). Both advisory firms clarified a number of their policies, and ISS issued a [FAQ](#) on its equity plan scorecard. **Policy changes** for 2016 include:
 - **Director “overboarding”:**
 - Starting for annual meetings on or after February 1, 2017, ISS will recommend against non-CEO directors sitting on more than five public company boards (as opposed to its current policy of more than six boards, which will remain in place for 2016). ISS will continue its policy of recommending against CEO directors on more than two “outside” boards.
 - Starting in 2017, Glass Lewis will recommend against CEO directors who sit on more than two “outside” boards and against non-CEO directors who serve on more than five public company boards. For 2016, Glass Lewis may note these levels as a concern, but will only recommend against directors under its current policy of more than three boards for CEO directors and more than six boards for non-CEO directors.
 - **Unilateral bylaw and charter changes:** Recognizing that investors may have different expectations for established public companies versus those that are newly public, ISS will separate its methodology for reviewing unilateral bylaw and charter changes, evaluating newly IPO’d companies on a case-by-case basis.
 - **Exclusive forum provisions:** For newly IPO’d companies, Glass Lewis will review exclusive forum provisions alongside other bylaw terms such as supermajority vote requirements and classified boards when determining whether to make a negative voting recommendation, as opposed to automatically doing so when a company adopts an exclusive forum provision without shareholder approval outside of a spin-off, merger or IPO.
 - **Proxy access:** ISS is clarifying its evaluation framework for proxy access candidates. An FAQ is expected this month with additional information on how it will evaluate proxy access provisions.
 - **Compensation practices of Externally Managed Issuers (EMIs):** ISS will consider it a problematic pay practice for EMIs to fail to provide sufficient disclosure for shareholders to evaluate named executive officer compensation.
- Determine whether your company needs to seek **shareholder approval of its stock incentive plan** for additional shares or material changes to the plan. Also, do not overlook whether reapproval of the plan under which your company grants 162(m) performance awards is needed. If the last time shareholders voted to approve your company’s 162(m) plan was 2011 or earlier, the plan should be disclosed and reapproved in 2016. Also, see [here](#) for Section 162(m) clarifications released earlier this year regarding the individual share maximums for options and SARs and the settlement of RSUs after the IPO grandfather period, as well as [recent guidance](#) on the potential inclusion of principal financial officers as covered persons for smaller reporting companies.
- If your company is adopting a stock incentive plan or revising an existing plan, consider including a director-specific “ceiling” (or other meaningful limits) on **director compensation** in order to obtain shareholder approval in light of recent litigation over director compensation (such as [this case](#) with respect to grants to directors at Citrix).

- Review the independence of your board's **compensation committee advisors** under [NYSE](#) and [Nasdaq](#) listing standards.
- Check your company's **Director & Officer questionnaire** to make sure it is up to date. *Reminder:* The SEC has offered [new guidance](#) this year on the definition of "spouse" to be inclusive of same-sex marriages. Consider this in drafting the questionnaire.
- Start thinking about how to present the **executive summary** of your company's Compensation Discussion & Analysis (CD&A). How can the company craft a compelling communication that is more visually appealing? Keep in mind that an executive summary can be an important tool to communicate with shareholders about what matters to your company. Keep it specific to have the biggest impact.
- Review this year's **Joint Committee on Employee Benefits (JCEB) Q&A with the SEC Staff** [here](#), which touches on topics including reporting equity awards for retirement-eligible executive officers and whether former compensation committee members should be named in the Compensation Committee Report.
- Find the recent SEC Staff Compliance and Disclosure Interpretations (C&DIs) discussing **unbundling** of proposals to shareholders under Rule 14a-4(a)(3) [here](#).
- Don't forget about the change in the **confidential treatment request process** [announced](#) by the SEC Division of Corporate Finance in 2014. If the Division grants a request for confidential treatment without comment, it will no longer notify the applicant. It will, however, continue to post orders granting confidential treatment through EDGAR.
- Remember to submit your company's "**glossy**" **annual report** to the SEC. Note that the SEC Staff is [no longer](#) uploading glossies to EDGAR.
- The SEC continues to expand the use of eXtensible Business Reporting Language (**XBRL**) technology in its new rule making. Visit the [XBRL portal](#) for useful links that will help you become more familiar with this technology and help ensure your company's submission is compliant.

LOOKING AHEAD

- "[Pay versus performance](#)" and "[pay ratio](#)" coming soon:
 - Keep an eye out for the final "**pay versus performance**" rules, which could be implemented as early as 2016 if final rules are published by the end of the year. New Item 402(v) is expected to require disclosure of the relationship between executive compensation and cumulative total shareholder return in both narrative and tabular formats.
 - Plan ahead for "**pay ratio**" disclosure, which will require companies to disclose the ratio of the compensation of their principal executive officer (PEO) to the compensation of their median employee.¹ Note that this disclosure will be required in 2018, so prepare to collect the appropriate information for fiscal year 2017.

¹ All employees, including non-U.S. (subject to limited exceptions), part-time, seasonal and temporary employees must be included in determining the median employee. The median employee can be identified using any "reasonable" method and the median employee must be determined at least once every three years. A company can choose any date within the last three months of its fiscal year to determine the median employee. The ratio may be expressed as a ratio where the median employee's compensation is 1 or narratively as a multiple of the PEO's compensation (e.g., "1 to 350" or "the PEO's compensation is 350 times the median employee's compensation").

- Did your company hold a **say-on-pay frequency vote** in 2011? If so, it will need to conduct a say-on-pay frequency vote in 2017 to comply with the [say-on-pay rule](#).
- **Clawback rules** are still in the proposal stage and are not expected to be finalized before 2016 but they may be in effect in the coming year. Under the [proposed rules](#), which apply to all public companies (including Emerging Growth Companies & Foreign Private Issuers), exchanges are directed to establish listing standards that require issuers to:
 - adopt and comply with policies to recover certain incentive-based compensation of executive officers from up to a period of three years in the event of a financial restatement; and
 - disclose those recovery policies.
- Note that while the SEC adopted [proposed hedging disclosure rules](#) earlier this year, the rules have not yet been finalized. The proposed rules require disclosure of whether employees or members of the board of directors are permitted to engage in transactions to hedge or offset any decrease in the market value of equity securities granted to or held by them.
- In July, the SEC issued a [concept release](#) on potential expansions of **audit committee disclosures** and solicited public comments.
- Note that other disclosure rules may also be getting a makeover in the coming years, with pushes to modernize disclosure requirements and make reporting more efficient.
 - As part of the SEC's **disclosure effectiveness project**, the Division of Corporation Finance is [reviewing](#) Regulation S-K and Regulation S-X and considering ways to improve reporting for both companies and investors. The review is first focusing on Forms 10-K, 10-Q and 8-K. [View](#) public comments received on this project.
 - In addition, Congress has issued, through the [F.A.S.T. Act](#), a mandate for the SEC to, among other things, make specific and detailed recommendations on modernizing and simplifying Regulation S-K requirements to reduce the costs and burdens on companies, while still providing all material information.
- Last week the SEC [proposed rules](#) on **resource extraction payments disclosure**. Initial comments are due by January 25, 2016, and reply comments, which may respond only to issues raised in the initial comment period, are due by February 16, 2016.

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If you have any questions, please contact any of the following attorneys or your Cadwalader contact:

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